Committee on Government Reform

Subcommittee on Energy and Resources
Darrell Issa, Chairman

Oversight Hearing:

Interior Department: A Culture of Managerial Irresponsibility and Lack of Accountability?

September 13, 2006, 2:00pm
Rayburn House Office Building
Room 2154

Briefing Memorandum

Summary

This Subcommittee is investigating the absence of price thresholds in deepwater leases between the Interior Department's Minerals Management Service and various oil and natural gas producing companies during 1998 and 1999. The Government Accountability Office estimates that the lack of price thresholds will cost the U.S. Government upwards of $10 billion in lost revenue over the life of the leases. According to GAO, this loss is estimated at nearly $2 billion to date.

Over the past seven months, the Subcommittee staff has reviewed documents surrounding nearly every aspect of the lease creation process. This includes an examination of the regulations, leases, lease sale documentation, decision memoranda, and bureaucratic processes. Moreover, the Subcommittee staff has interviewed multiple witnesses, and Chairman Issa has conducted three oversight hearings at which individuals intimately familiar with the leasing process have supplied critical information.

There is every indication that carelessness and irresponsibility contributed to this unprecedented loss to the American people. Professional negligence, however, is not peculiar to the Minerals Management Service.

In addition to its investigation which mirrors ours, the Interior Department's Office of the Inspector General has investigated numerous alleged infractions involving Department employees. The OIG reluctantly posits that the Department suffers from an institutionalized culture of managerial irresponsibility and a general lack of accountability.

Interior Inspector General Earl E. Devaney will testify about the results of his investigation into the missing price thresholds, as well as the culture that, at times, undermines the integrity of the Interior Department.

This is a matter of paramount concern in light of Chevron's recently announced new discovery in the OCS Gulf of Mexico region that may include leases signed in 1998 and 1999.

BACKGROUND

The Deep Water Royalty Relief Act

To appreciate the magnitude of this blunder, it is useful to understand the policy behind the Deep Water Royalty Relief Act and what Congress sought to accomplish. In 1995, Congress enacted the Deep Water Royalty Relief Act[1] (the "Act") to provide financial incentives to oil and gas companies to explore and extract oil and natural gas from our deep coastal waters. This came at a time when oil and natural gas prices were low and the interest in deepwater drilling was lacking. The Act – tirelessly lobbied for by Democratic Senator J. Bennett Johnston of Louisiana and enacted by a Republican Congress – provided a mechanism by which the Secretary of the Interior and oil and gas companies were to enter into leases of federal waters. Furthermore, the Act provided the critical royalty relief terms these leases were to include.

Effective November 28, 1995, companies with eligible leases would be allowed to operate royalty-free until either a certain volume of production was achieved, or the market price for oil or gas reached a specified ceiling. Upon the occurrence of either event, companies would begin paying royalties to the U.S. government at an agreed-upon percentage rate. These lease terms, also known as volume suspensions and price thresholds[2], became critical components of thousands of leases entered into between 1995 and 2000. To begin leasing property under the Act, however, it was first necessary for the Department to promulgate a rule delineating the process by which it would award leases and grant royalty relief.

Given the immediacy of the Act's effective period, the Department published an interim rule on March 25, 1996. This interim rule contained, among other things, a bidding system and a royalty relief scheme for eligible leases. Throughout 1996 and 1997, hundreds of leases were entered into pursuant to the guidelines set forth by this interim rule. It was not until January 16, 1998 that the Department issued a final rule. For the remainder of the effective period (1998 through 2000), leases were then entered into pursuant to the final rule.

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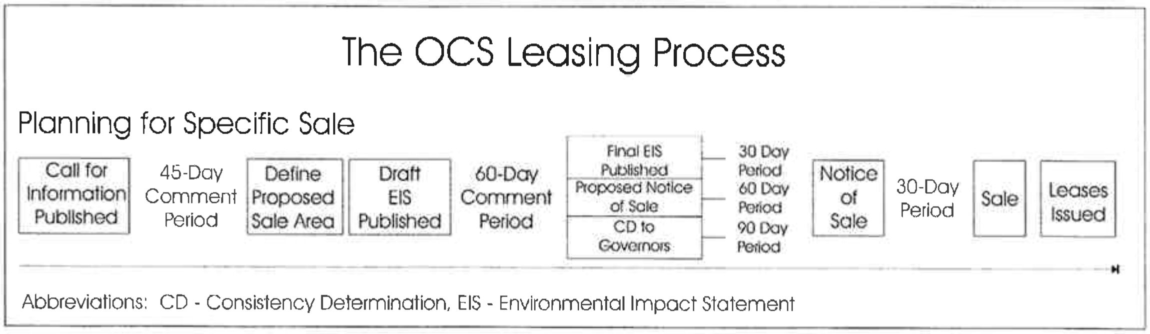
[1] 43 U.S.C. 1337 (1995)

[2] The implementation of volume suspensions was mandatory, whereas price thresholds were discretionary.

The OCS Leasing Process



The leasing process is quite involved and occurs over a period of approximately one year. After a lengthy planning stage that includes multiple studies and numerous reviews, the Department advertises in the Federal Register a particular area that it intends to lease. This advertisement, otherwise known as a "final notice of sale," includes the terms and conditions of the lease sale. (These terms include, among other things, a description of the land and royalty relief provisions applicable to qualifying leases.) The Department then enters a bidding phase, wherein multiple companies compete for the right to lease and drill on the land described in the notice. Successful bids are awarded leases. These leases include the terms and conditions described in the final notice of sale and are governed by statute and Departmental regulations. This process, which appears remarkably simple on its face, requires a tremendous amount of legal and bureaucratic oversight within the Department.

At nearly every turn, there are decision memoranda passed among multiple levels of management for their review and approval. This is true not only for the leasing process, but also for the drafting and promulgation of the regulations. All told, there are nearly thirty surnames required for every lease sale, including those of every supervising and reviewing attorney in the Solicitor's Office[3]. Incidentally, some of the attorneys and Department officials who reviewed and signed off on the interim and final regulations, the final notices of sale, numerous decision memoranda, and who signed the problematic leases, are employed by the Department to this day and remain intimately involved with the leasing process.

THE PROBLEM

The United States Government faces an enormous problem at the hands of the Interior Department. Neither the regulations promulgated by the Department, nor the leases entered into during 1998 and 1999, contained the critical price threshold provisions contained in leases signed in 1996, 1997, and 2000. (In 1996, 1997, and 2000, price thresholds and volume suspensions were included in addenda to the lease documents because the interim regulation failed to impose price thresholds. In 1998 and 1999, the Department discontinued the practice of detailing royalty provisions in addenda.)

[3] A "surname" is a signature that indicates an approval of the contents of the document on which it appears. See Attachment 2, a spreadsheet furnished by the Interior Department which contains a list of every name and title of those individuals involved in the lease sale review and approval.

Consequently, companies that signed leases eligible for royalty relief in 1998 and 1999 are able to sell oil and gas at fair market value until they produce the amount permissible under the volume suspension scheme. In 1998 and 1999, fair market value of a barrel of oil was well under $20. Today, it is nearly $66. For natural gas, in 1998 and 1999, the price per thousand cubic feet was about $2. Last year it averaged $7.51. This means that in a field greater than 800 meters depth, lessees are producing and selling millions of barrels of oil and trillions of cubic feet of natural gas at today's market price royalty-free until volume suspensions expire. As a result, these companies are not surrendering billions in royalties owed to the American people.

Accordingly, the purpose of this investigation is to determine why price thresholds do not appear in leases entered into during 1998 and 1999, and identify those individuals who either caused the error or who were in the best position to rectify the problem and failed to do so. Moreover, an ancillary objective is to identify and pursue whatever measures are necessary to remedy this error. This is especially important in light of Chevron's recently announced new discovery in the OCS Gulf of Mexico region that may include leases signed in 1998 and 1999.

HISTORY OF THE INVESTIGATION

The Subcommittee became aware of this problem by way of a *New York Times* article published in late January of 2006. The Subcommittee subsequently engaged in an aggressive oversight investigation into the allegations in that article. The investigation includes three oversight hearings at which oil company executives and Interior Department officials have testified, witness interviews, and an intense document review.

RECENT FINDINGS

The Subcommittee staff has identified the Department employees who were responsible for the missing price thresholds. The June 21st hearing unveiled the Interior Department attorney responsible for the promulgation of regulations without price thresholds. The Department, therefore, implemented the Deep Water Royalty Relief Act with rules that failed to impose price thresholds. As a result, over a thousand deepwater leases did not contain price thresholds. The lack of price thresholds in these leases allows companies to sell oil and natural gas at record-high market prices without paying billions in royalties.

But even more explosive than the Interior Department attorney's testimony was that of a Chevron Corporation official. Government Reform Committee Chairman Tom Davis signed five subpoenas to compel the testimony of oil executives after they declined invitations to testify. (Though four of the companies begrudgingly agreed to testify under threat of subpoena, Shell Corporation continually refused and its president, John Hoffmeister, was served.) The purpose of eliciting industry testimony was to determine the extent of its interaction with the Department regarding the faulty leases.

According to a Chevron official's testimony, Chevron employees met with Department officials in 1998 concerning the missing price thresholds in deepwater leases. At

Chairman Issa's request, Chevron detailed in follow-up correspondence how two of its employees had three meetings with Chris Oynes, Director of the Gulf of Mexico Region, to discuss the problematic leases. These discussions occurred over the course of three quarterly meetings between members of the American Association of Professional Landmen's Outer Continental Shelf Committee[4] and Mr. Oynes and his staff during 1998 and 1999.

The general purpose of these quarterly meetings was to discuss various issues related to the Minerals Management Service's administration of offshore oil and gas leasing. According to Chevron officials, two Chevron employees allegedly informed Mr. Oynes and his staff on three separate occasions that price thresholds were imposed neither through the regulations nor in addenda to 1998 and 1999 leases. Mr. Oynes first replied that the price thresholds were contained in the 1998 regulation, but when subsequently informed by the Chevron employees that they were not, he apparently indicated that he would have his staff review the issue. It is now clear that Mr. Oynes and his staff failed to take corrective measures despite allegedly being notified on three separate occasions that the leases did not contain price thresholds.

The Subcommittee examined Mr. Oynes and Deputy Director of MMS Charles Shoennagel at its July 27, 2006 oversight hearing. They purported to have no recollection of the conversations recounted in detail by the Chevron employees. When asked specifically about when they *did* become aware of the missing price thresholds, they professed not to know until 2000. Mr. Oynes maintained that though he was aware that the addenda no longer appeared as part of the leases, he was assured that the price thresholds were contained in the governing regulations. Apparently, neither he nor his staff of 550 employees noticed the error during the entire 1998-1999 period. Mr. Oynes ultimately offered that "wires were crossed" and that "the right hand did not know what the left hand was doing."

The clearest example of unaccountability and professional negligence is the surname process required for official departmental action. At nearly every turn, there are decision memoranda passed among multiple levels of management for their review and approval. This is true not only for the leasing process, but also for the drafting and promulgation of departmental regulations. All told, there are nearly thirty surnames required for every lease sale, including those of every supervising and reviewing attorney in the Solicitor's Office. So many people are involved that nobody is ultimately accountable for the final product. Furthermore, many surnames on these lengthy documents appear on the same day.

INSPECTOR GENERAL EARL E. DEVANEY'S FINDINGS

Inspector General Devaney has conducted numerous investigations over the past seven years. What he has discovered is a culture of unaccountability and managerial

[4] The AAPL OCS Committee, during 1998 and 1999, was comprised of representatives from most of the major oil and gas producing companies that held deepwater leases including Exxon, Mobil, Texaco, Phillips, et al.

irresponsibility that pervades many areas of the Department. Mr. Devaney's testimony at the September 13, 2006 hearing will not only address the findings of the OIG investigation into the missing price thresholds, but also the culture of the Interior Department and its consistent failure to take corrective actions.

Conclusion

The American people have been shortchanged by Interior Department personnel. Some of these Department officials, who today remain employed in their same capacities, are responsible for a nearly $10 billion loss of revenue generated from our outer continental shelf.

Witnesses

- Interior Department Inspector General Earl E. Devaney